Canada and NAFTA: A 10-Year Measure of Success in Canadian-U.S. Agricultural Trade

By George C. Myles and Matthew Cahoon

It may not be obvious, but the United States and Canada have the world's largest bilateral trading relationship. In 2002, total trade between the two countries was $411 billion. Merchandise trade alone was $370 billion, translating into more than $1 billion in goods crossing the border each day. When services are added, the daily total equals $1.1 billion.

Sizing Up Canadian-U.S. Trade

Canada ships 87 percent of its merchandise trade exports to the United States, and receives 63 percent of the goods it imports from the United States. On the flip side, 23 percent of U.S. merchandise exports go to Canada, and 18 percent of the goods the United States imports come from Canada.

The agricultural provisions of the CFTA (U.S.-Canada Free Trade Agreement), which began taking effect in 1989, were incorporated into NAFTA (the North American Free Trade Agreement). All tariffs affecting agricultural trade between the United States and Canada, except for a few items covered by tariff-rate quotas, were removed by Jan. 1, 1998.

Agricultural trade with Canada has continued to flourish under NAFTA. As noted elsewhere, Canada is the No. 1 market for U.S. agricultural exports, purchasing $8.7 billion worth in calendar 2002, and exports were forecast to reach $9.4 billion in 2003. Since 1994, U.S. agricultural products to Canada have accounted for almost half of total growth in U.S. agricultural exports worldwide, and the growth rate has significantly outpaced that of sales to the rest of the world. The average annual growth rate of U.S. agricultural product exports to Canada since implementation of NAFTA was 5.1 percent, while that for the rest of the world was only 1 percent.

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Two-way agricultural trade between the United States and Canada for 2003 was poised to reach $21 million, about double the 1994 figure, before the discovery of bovine spongiform encephalopathy in Canada last May. Subsequent emergency trade restrictions on U.S. imports of Canadian cattle and beef resulted in lower export values for two of Canada's leading agricultural exports.

A Sector-by-Sector Review

Although U.S. imports of Canadian agricultural products have grown under NAFTA, mostly of red meats, live animals and frozen potato fries, U.S. exports of a wide range of bulk, intermediate and consumer-oriented agricultural products to Canada registered significant gains. Without the trade agreements, the United States would have lost these expanded export opportunities.

Spurred by an increase in coarse grain exports, U.S. bulk commodity exports to Canada for 1994-2003 increased at an annual average of more than 10 percent, creating a $1.0 billion market. U.S. intermediate exports rose more than $500 million. U.S. high-value food exports grew at an annual average rate of 4.5 percent and have created a stable $6.0 billion market for U.S. manufactured consumer food products.

Besides the market opportunities created by zero tariffs, NAFTA has given Canadian consumers greater freedom to determine the demand for high-value agricultural products in a more competitive marketplace. Canada's wholesale, retail and food service industries are watching with acute interest developments in U.S. packaged and processed foods and service trends. Canadians learn about new and innovative U.S. food products about as soon as U.S. consumers do via the media and frequent business and personal travel to the United States. These information sources create an immediate demand that helps ensure the success of U.S. high-value food products.

As demand accelerates and two-way trade expands, food policy makers in Canada recognize the importance of working with the NAFTA partners toward harmonization in food packaging and nutrition labeling regulations. These developments promise further impetus for accelerated trade for the NAFTA partners in the coming years.

Good Produce Makes Good Neighbors: Under the tariff phase-out provisions of NAFTA, U.S. fresh vegetable exports to Canada enter duty-free; seasonal duties are no longer applicable. Although a tariff snapback provision remains in effect until 2008, it has been used sparingly by Canada, and not at all in recent years.

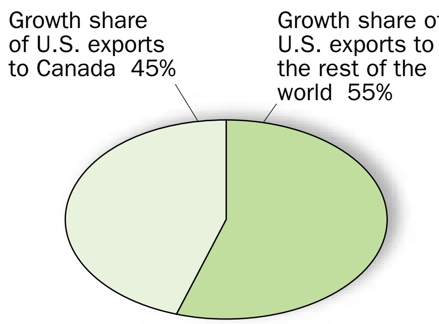
NAFTA has enabled U.S. fresh vegetable exporters to benefit from the expanding opportunities in the Canadian market, stemming from increased demand in the food service sector and higher fresh market sales to Canada's growing number of Asian immigrants, whose traditional diet includes large amounts of fresh vegetables. Canada has one of the world's highest consumption rates of fresh vegetables. In Canadian retail grocery stores, more space is devoted to fresh produce than to any other food sector.

U.S. fresh vegetable sales to Canada reached $964 million in 2002 and posted an annual average growth rate of 4.2 percent since NAFTA implementation. Sales were set to exceed $1.0 billion in 2003, making Canada the No. 1 market for U.S. exports in this product category. NAFTA border facilitation measures and modern transportation and wholesale dealer networks provide Canadian fresh vegetable buyers with prompt delivery.

The Chicken and the Egg: Prior to the trade agreements, Canada imposed specific import controls on all major poultry and egg product trade. U.S. exports were restricted to quotas based on the previous five-year historical access level. Under the CFTA and NAFTA, U.S. negotiators increased access to fixed percentages of Canadian production of the products, thus enabling exports to grow as the market expanded.

In January 1995, the Uruguay Round of the General Agreement on Tariffs and Trade was implemented, and Canada converted its import protection for poultry to a TRQ (tariff-rate quota) system. The Canadian government honored its NAFTA commitment, whereby U.S. access was higher than Canada's minimum access requirements under the Uruguay Round provisions.

For 1994-2002, Growth in U.S. Agricultural Exports to Canada Mirrored Worldwide Increases



U.S. negotiators had insisted that certain processed poultry items be exempt from Canada's list of items included in the poultry meat TRQ, and in recent years, U.S. exports of these items have increased. In addition, the Canadian government was obliged to establish special supplementary import categories to enable Canadian food manufacturers who use poultry meat ingredients to import additional U.S. poultry meat, in order to improve their competitiveness with similar products of U.S. manufacture that enter Canada duty-free under NAFTA.

These factors have resulted in steady and substantial growth in U.S. poultry meat exports that may not have occurred without NAFTA. Today, Canada is the No. 2 export market for U.S. chicken. Total U.S. poultry exports to Canada in 2003 are estimated at about $290 million, a 77-percent gain over the pre-NAFTA level.

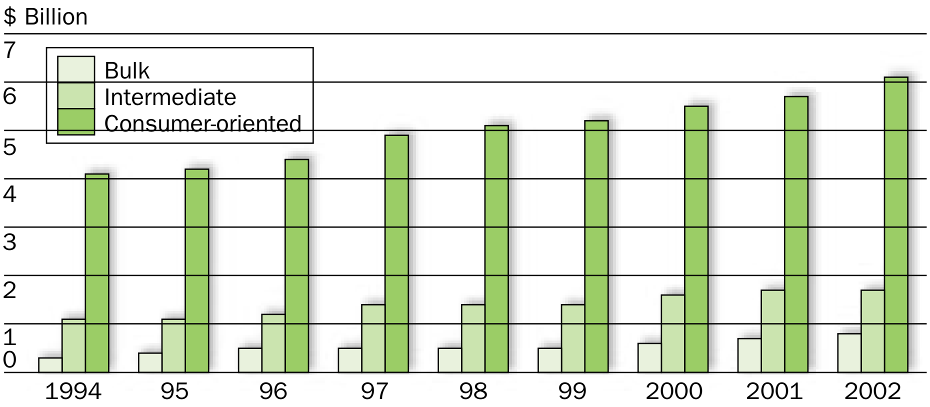
Dairy Products Tending Upward: Implementation of the Uruguay Round provisions one year after NAFTA saw Canada's import control regime switch from a system of import quotas to a TRQ system in order to protect Canada's fluid milk production. TRQs were established for fluid milk and dairy products, including yogurt, powdered whey, specialty creams, dairy spreads, ice cream and ice cream novelties, cheeses, butter and margarine. Under the TRQ system, imports are subject to low duty rates up to the limit, and to higher rates over the limit.

Despite the high tariff rates on over-quota volumes and the creation of certain value-added dairy products that were either excluded from the list of products to which a TRQ would apply or have been developed since the conversion from quotas to TRQs, U.S. exports of dairy and dairy-containing products to Canada have more than tripled. For 1994, U.S. exports totaled $75.9 million; for 2002, they were $254.6 million. Leading U.S. exports in this sector include preparations for infant use (containing over 10 percent by weight of milk solids), pizza and quiche, dry whey, milk albumins/whey protein concentrates, milk-based drinks and processed cheeses.

Livestock and Grain Gains: Cross-border trade and investment increased under the trade agreements. U.S. grain corn shipments to Canada benefited as the U.S. and Canadian livestock industries became more integrated. As market integration advanced, Canadian livestock numbers grew.

Despite increases in Canada's planted corn area, U.S. corn sales rose sharply to meet feed grain demand. In 2002, western provinces accounted for the majority of U.S. corn sales in Canada. Rising demand for corn for industrial purposes, namely ethanol and sweetener production, outstripped supply in Canada's traditional

Exports of U.S. Consumer-Oriented Products Lead NAFTA Sales Growth to Canada



eastern corn-growing region. In 2002, U.S. grain corn exports reached 4.0 million metric tons valued at $395 million, more than five times their value when NAFTA was first implemented.

Pet Foods Popular: The pre-CFTA/NAFTA tariff on U.S. pet foods for dogs and cats was 6 percent ad valorem. Under NAFTA, U.S. pet food manufacturers have seized opportunities to benefit from a decade-long Canadian boom in pet ownership through increased pet food sales and investments. In recent years, several familiar pet superstores have set up retailing operations in Canada's major cities, and all carry the major U.S. brands. Canadians currently own about 8 million dogs and cats. Total retail sales (food, accessory and veterinary costs) are expected to exceed $1.5 billion in 2003. U.S. pet food sales to Canada have surged by 40 percent under NAFTA, reaching $275 million in 2003.

Snack Food Sales Swell: Before 1989, Canada applied moderately high tariffs, mostly 5-10 percent, on imports of U.S. salty snacks (popcorn, corn chips, potato chips and pretzels) and bakery snack foods (crisp breads, cookies, waffles and wafers). In general, an ascending scale typified the tariff-rate structure—the more processed the item, the higher the import duty to protect domestic manufacturers.

Under NAFTA, Canada's snack food industry has become highly concentrated, and now includes national, regional and multinational firms. It is estimated that the leading four enterprises supply over 85 percent of total Canadian snack food production. Canada's snack food industry primarily serves the domestic market. Prior to the CFTA, imports supplied about 3.2 percent of the domestic market. Although Canadian companies continue to hold a substantial portion of the snack food market, imports, mostly from the United States, have captured about 15 percent of it.

With Canada's snack food industry invigorated by the trade agreement provisions, Canadian demand also rose for key commodity inputs needed to make snacks. While many of these products, such as potatoes and oil, are supplied by domestic sources, demand has increased for many other U.S. inputs (corn meal, seasonings, etc.), reflecting the economic multiplier effect of freer trade. Imports of snack foods (excluding nuts) from the United States in 2003 are expected to have reached a record $725 million.

Canada's Perspective

How has NAFTA worked for Canada? According to Canada's Department of Foreign Affairs and International Trade, NAFTA has brought economic growth and rising standards of living for people in Canada, the United States and Mexico. The Canadian department claims that NAFTA has established a strong foundation for future growth and set a valuable example of the benefits of trade liberalization.

NAFTA is the world's largest trade bloc, with a gross domestic product of $11.4 trillion, about one-third of the world's total. Each day, NAFTA member countries conduct nearly $1.7 billion in trilateral trade. Thanks largely to NAFTA, North America is one of the most competitive, prosperous and economically integrated regions in the world.

From 1993 to 2001, Canada's merchandise exports to its NAFTA partners climbed 95 percent, from $117 billion in 1993 to $229 billion in 2001. By contrast, Canadian exports to the rest of the world in the period increased only 5 percent. During the first seven years of NAFTA, annual foreign direct investment in Canada averaged $21.4 billion, almost four times the average registered over the seven years preceding NAFTA. ■

Myles is a senior agricultural specialist and Cahoon is an agricultural specialist with the FAS office at the U.S. Embassy in Ottawa, Canada. Tel.: (1-613) 688-5267; Fax: (1-613) 688-3124; E-mail: usagr@istar.ca